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No. 02-1569

IN THE

Supreme Court of the United States

AMERICAN TELEPHONE AND TELEGRAPH COMPANY,
and
LUCENT TECHNOLOGIES INC.,
Petitioners,

v.

THE UNITED STATES,
Respondent.

On Petition For A Writ of Certiorari To The United States Court of Appeals for the Federal Circuit

PETITIONERS' REPLY BRIEF

Of Counsel

STEPHEN R. ROSEN
LUCENT TECHNOLOGIES INC.
Murray Hill, NJ

THOMAS R. SUHER
GORDON LAW OFFICES
Greensboro, NC

C. STANLEY DEES
Counsel of Record
LAWRENCE S. EBNER
MICHAEL A. HOPKINS

MCKENNA LONG &
ALDRIDGE LLP
1900 K Street, N.W.
Washington, D.C. 20006
(202) 496-7500

Attorneys for Petitioners

WILSON-EPES PRINTING CO., INC. – (202) 789-0096 – WASHINGTON, D. C. 20001

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PETITIONERS' REPLY

Petitioners AT&T and Lucent offer the following points in response to the Government's opposition brief and in further support of their petition for a writ of certiorari:

1. ***The question presented is extraordinarily important to the nation's defense industrial base: Can the United States exploit a highly skilled defense contractor by knowingly awarding an illegal, economically predatory contract for development of a vital defense system and then, after the work is successfully completed, automatically escape all judicial redress when the aggrieved contractor seeks compensation for its enormous financial losses?*** Contrary to the impression that the Government's brief tries to create, this is *not* some isolated issue that has little relevance to the federal procurement system upon which our national defense depends. Instead, "[t]he defense contracting industry as a whole stands to suffer if the holding below stands." Br. of the Nat'l Defense Indus. Ass'n and the Gov't Electronics & Info. Technology Ass'n as *Amici Curiae* in Support of Petitioners at 17. The "Federal Circuit's decision will prevent defense contractors . . . from obtaining traditional and appropriate contract remedies when the contractors incur losses on illegal contracts or contracts with illegal terms." *Id.* at 1. Unless this Court restores clarity and sanity to this crucial area of federal procurement law by reviewing and reversing the opinion below, the already shrinking pool of high-tech defense contractors will be forced to seriously consider whether to forgo bidding on the very type of long-term, technologically challenging, R&D contracts that are essential to maintaining the nation's military superiority and homeland security.

The Government's brief acknowledges that the "fixed-price development contract" involved in this case "did not meet the conditions imposed by Section 8118" of the Defense Appropriations Act of 1988. U.S. Br. at (I); *see also id.* at 2. This blandly worded concession significantly

understates the grave, *illegal* nature of DoD's egregious actions here (and in the *many* other major defense procurements which violated § 8118 or its successors): Congress had "strong concern . . . over [DoD's] increasing use of fixed price-type contracts for engineering development" of major defense systems (a heavily criticized practice which flagrantly violated DoD's own longstanding acquisition guidelines), and the need to "maintain the government's credibility as a reliable business partner." H.R. Conf. Rep. No. 100-498 (1987), at 623. Following a House Appropriations Committee investigation and hearings, Congress enacted § 8118 as part of the 1988 defense appropriations statute to prevent *exactly* the type of financial abuse of contractors which subsequently occurred in this case – successful performance of a technologically demanding R&D contract (here, development of an "RDA" Soviet submarine surveillance system which the President's Annual Report to Congress for Fiscal Year 1987 (p. 188) described as "[o]ne of our most important ongoing programs") at a cost *far in excess* of the fixed contract price which DoD *compelled* the contractor to propose.

As the Government's brief explains, § 8118 "provided that appropriated funds *could not be obligated or expended* for major fixed-price development contracts unless the Under Secretary of Defense for Acquisition" first determined, in writing, that "realistic pricing can occur," and also that "the contract type permits an equitable and sensible allocation of program risk between the contracting parties." U.S. Br. at 2 (emphasis added). In other words, the plain language of § 8118 conveyed Congress' unequivocal intention to *protect defense contractors* by making appropriated funds available for fixed-price development contracts *only if* the upper echelon of DoD first made this required written determination. By purporting to award the RDA contract on a fixed-price basis in the absence of the required determination, DoD unlawfully, and quite possibly unconstitutionally, obligated and expended funds which *had not been made available by Congress* (i.e., which exceeded

the funds appropriated by Congress) for obligation or expenditure on major defense contracts. This is precisely the sort of conduct which the Government's brief indicates violates the Anti-Deficiency Act, an organic statute rooted in Congress' "power of the purse." *See* U.S. Br. at 10 (citing 31 U.S.C. § 1341(a)(1)); U.S. Const. art. I, § 9, cl. 7; *see generally Hercules, Inc. v. United States*, 516 U.S. 417, 427 (1996) ("The Anti-Deficiency Act bars a federal employee or agency from entering into a contract for future payment of money in advance of, *or in excess of,* an existing appropriation.") (emphasis added); *Thompson v. Cherokee Nation*, No. 02-1286, 2003 WL 21511710, at *15 (Fed. Cir. July 3, 2003) ("if an agency, 'in the absence of statutory authority, make[s] promises that impose an obligation on the federal Treasury, [it] exceed[s] [its] constitutional authority and abrogate[s] Congress' authority under the Appropriations Clause' ") (quoting *Schism v. United States*, 316 F.3d 1259, 1288 (Fed. Cir. 2002)).

For this reason, as the Court of Federal Claims ("CoFC") held at the outset, the RDA contract was void *ab initio*. *See AT&T I* (Pet. App. at 127a-128a) ("absent compliance with the written determination requirement of Section 8118, *no authority to obligate funds came into being* and thus *no valid contract* was created") (emphasis added). The "multitude of opinions by the members of the Federal Circuit in this case" (U.S. Br. at 9), reflect that court's long struggle, striking indecision, and strong internal disagreement – which only this Court can resolve – regarding what to do about a fully (and successfully) performed defense contract that was void *ab initio* due to DoD's surreptitious violation of a mandatory prohibition in an appropriations statute. Although DoD's *admitted* violation of § 8118 caused AT&T to incur a huge financial loss, the Government's brief asserts that "not one appellate judge has expressed the view that petitioners are entitled to any relief in this case." U.S. Br. at 9. But that is not surprising since the Government thus far has succeeded in depriving Petitioners of a trial on their claims for relief. As

Judge Newman, who authored the *AT&T III en banc* opinion which "remanded [this case] to the [CoFC] for consideration of the question of relief," emphasized in her sharply worded dissenting opinion below, "AT&T has not yet had its day in court." Pet. App. at 16a, 18a.

Mimicking the majority opinion below, the Government's brief asserts that Petitioners are not entitled to relief because of "[t]he absence of any right of action to enforce Section 8118." U.S. Br. at 7. The Government cavalierly asserts that § 8118 was not enacted "for the benefit of private defense contractors." *Id.* at 8 n.2. To the contrary, § 8118, by its very nature, "[q]uite plainly . . . has more than the Government's own interests in mind[;] [it] encompasses the interests of both parties – *contractors* as well as the Government." *AT&T I* (Pet. App. at 121a) (emphasis added). The Government's brief also repeats the majority opinion's reference to supposedly relevant *post hoc* "legislative history" authored by a Senate committee that was not responsible for enactment or oversight of § 8118 or its successors. *See* U.S. Br. at 7. As the petition explains, the committee report in question specifically stated that it was not intended to affect the requirements of § 8118, which DoD, by its own admission, violated here. *See* Pet. at 25-26.

The Government's brief also asserts that the opinion below is consistent with the "principle that a contract that the government unlawfully entered into does not *automatically* entitle the contractor to judicial relief." U.S. Br. at 8 (emphasis added). Petitioners do not contend, however, that they are "automatically" entitled to relief; what they contend is (i) that the RDA contract (or its pricing term) was invalid due to DoD's violation of § 8118, and (ii) that they have brought valid claims (under the Contract Disputes Act and Tucker Act), and have the right to pursue them.

The Federal Circuit erroneously held, however, that because the procurement-related statute that has been violated (i.e., § 8118) does not contain an *explicit* right of action, Petitioners' claims must be automatically dismissed.

Pet. App. at 6a-7a. The Government's brief attempts to downplay the *drastic*, *unprecedented* nature of this holding, for example, by interjecting the red herring that the panel majority also indicated that there is no implicit right of action in § 8118. U.S. Br. at 8. But only last month, the Government filed a summary judgment reply brief in *Gould, Inc. v. United States*, No. 95-88C, a CoFC case involving an allegedly illegal contract, in which the Government, relying upon the *AT&T V* opinion below, argued that absence of an explicit right of action in the defense appropriations act was *determinative*:

> Here, like AT&T, there is *no explicit right of action* in the language of the Act. . . . The focus must first be with the *explicit language* of the statute itself. *If no private right of action is recited, then none exists.*

Def. Reply Br. at 6, 7 (filed June 2, 2003) (emphasis added).

If allowed to stand, the Federal Circuit panel majority's new rule regarding the need for an explicit right of action in the appropriations or other procurement statute that has been violated will continue to engender inconsistency, uncertainty, and confusion, if not an impassable roadblock, whenever an aggrieved contractor files a claim against the United States alleging that a contract or contract term is illegal. *See* Pet. at 18-24; Br. of *Amici Curiae* at 3-14. The Federal Circuit's exclusive jurisdiction over such claims only heightens the need for this Court's immediate review.

2. *The Government's assertion that "the question presented does not recur with enough frequency to warrant this Court's review" (U.S. Br. at 10) is disingenuous.* As the Government is aware, this is hardly the only suit in which a defense contractor has sought relief based on DoD's violation of § 8118. *See, e.g., Northrop Grumman Corp. v. United States*, 47 Fed. Cl. 20, 48-49 (2000) (holding that "[b]y failing to make risk determinations . . . DoD violated the statutory prerequisites for the funding of this fixed-price

incentive contract"). Nevertheless, according to the Government, Petitioners cite "only" three pending CoFC cases involving § 8118 or its successors, "and those cases *do not necessarily present the same issues* as in this case." U.S. Br. at 10 (emphasis added). But in those cases, which collectively add up to a ***billion dollars*** in pending claims against the United States (*see* Pet. at 14), the Government has *seized* upon the *AT&T V* opinion below *as dispositive authority*. For example, two weeks after the opinion was issued, the Government requested leave to submit it as supplemental authority supporting summary judgment in *Short Bros., PLC v. United States,* No. 98-894C. The Government asserted that "in AT&T, the Federal Circuit *rejected the very claim* that forms the basis of Count 1 of plaintiff's complaint in this case." Def. Motion for Leave to File Suppl. Auth. at 2 (filed Oct. 24, 2002) (emphasis added). In a subsequent brief in the same case, the Government argued "that plaintiff's *attempt to distinguish* the AT&T decision is *without merit*." Def. Motion for Leave to Submit a Reply at 4 (filed Nov. 8, 2002) (emphasis added).

CTA Inc. v. United States, No. 96-113C, is another pending § 8118 case which the Government here duplicitously implies is readily distinguishable (U.S. Br. at 11). The CoFC, at the joint request of the Government as well as the contractor, has held all proceedings in abeyance since April 2001, including a ruling on the parties' summary judgment motions, pending the final outcome of *AT&T*. In the parties' most recent joint status report, prepared and filed by the Department of Justice, the Government notified the court that "*both parties* believe that it would be *appropriate to wait* until the *AT&T* decision has become final . . . before advising this Court regarding further proceedings in this case." Joint Status Report at 2 (filed June 6, 2003) (emphasis added). As far back as 1996 "the parties stated the decision from the . . . Federal Circuit [in *AT&T*] may have a *significant impact on the outcome of this case*." Order (filed April 3, 2001) (emphasis added). The Government's

brief to this Court, however, misleadingly suggests that the opinion below is inapposite to *CTA*.

Northrop Grumman Corp. Military Aircraft Div. v. United States, No. 96-760C, is yet another § 8118 case (involving claims exceeding $750 million) which the Government's brief attempts to distinguish here (U.S. Br. at 10-11). The CoFC has stayed the Government's Partial Motion to Dismiss, however, and directed the Government to file a notice regarding the status of the *AT&T* certiorari petition within five days of any action taken by this Court. Order (filed May 14, 2003).[1]

Equally significant, but astonishingly, undisclosed in its brief to this Court, the Government has been *aggressively* utilizing the opinion below as the centerpiece of its efforts to achieve dismissal of ***billions*** of dollars in pending contractor claims involving alleged DoD violations of ***other*** procurement statutes or regulations. For example, in *Gould, Inc. v. United States*, No. 95-88C, the Government's recent summary judgment reply brief argues to the CoFC that "the statute in AT&T was a funding statute, *similar in material respects* to the statute at issue here." Def. Reply Br. at 4 (filed June 2, 2003) (emphasis added); *see also* Pet. at 15. And although the Government's opposition brief here asserts that the Federal Circuit's holding in *AT&T V* "is neither remarkable nor novel" (U.S. Br. at 9), its reply brief in *Gould* vigorously argues to the contrary. According to the Government's *Gould* brief, *AT&T V* effectively overruled the Federal Circuit's earlier holding in *Gould, Inc. v. United*

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[1] Section 8118 also has been an issue in the long pending "A-12" litigation, in which several **billion** dollars are at stake. *See McDonnell Douglas Corp. v. United States*, 323 F.3d 1006, 1010-12 (Fed. Cir. 2003) (discussing case background). The litigation involves the Navy's award in 1988 of "a fixed-price contract . . . to research and develop a carrier-based 'stealth' attack aircraft called the 'A-12 Avenger.' " *Id.* at 1010.

States ("Gould IV"), 67 F.3d 925 (Fed. Cir. 1995), that the contractor has stated a claim upon which relief can be granted. More specifically, the Government's *Gould* reply brief, referring to *AT&T V*, argues that "[e]ven if [the] law of the case arguably applied here, there is no occasion to enforce it because *subsequent controlling authority has changed the law*." Def. Reply Br. at 4 (emphasis added). To underscore that the *AT&T V* opinion represents a sea change in federal procurement law, the Government's *Gould* brief attempts to dispose of prior Federal Circuit cases involving illegal contract terms as "pre-AT&T decisions." *Id.* at 16. Thus, the Government's recent arguments in *Gould* belie its efforts here to minimize the far-reaching significance of the opinion below.

Moreover, there are additional recent cases, unrelated to § 8118, in which the Government has brandished the opinion below in efforts to deprive contractors of their day in court. For example, in *La Gloria Oil and Gas Co. v. United States,* 56 Fed. Cl. 211, 226 (2003), the Government, citing *AT&T V*, "argue[d] for the first time . . . that [the contractor] has waived its right to challenge the legality of the EPA [economic price adjustment clause] used in its contracts." *See also C.W. Over & Sons, Inc. v. United States*, 54 Fed. Cl. 514, 522-23 (2002) (adopting the Government's *AT&T V* waiver argument). *La Gloria* is only one of the pending "jet fuel" cases. Alleging that they were underpaid because of DoD's use of an illegal EPA clause in military jet fuel supply contracts, about 25 oil companies have filed claims against the United States totaling more than **$2 billion**. *See* Jeremy Feller, *Sunoco Sues U.S. Over Fuel*, Philadelphia Business Journal, May 20, 2002.

Congress routinely enacts defense procurement legislation which prohibits use of particular contract types or terms. *See, e.g.*, 10 U.S.C. §§ 2304b(b) (task order contracts exceeding five years), 2306(a) (cost plus percentage of cost contracts), 2401(c) (long-term lease or charter of aircraft or naval vessels). Unless this Court reviews and reverses the

Federal Circuit's opinion below, the Government will continue to wield *AT&T V* as a weapon which can summarily terminate any claim alleging that DoD violated a statutory or regulatory requirement or prohibition governing pricing or other material terms of defense contracts.

3. *There is no basis for the Government's contention that Petitioners have waived their entitlement to relief.* Relying upon majority opinion *dicta*, the Government, *which admits that it violated § 8118*, asserts that AT&T "waived whatever claims it had to recovery" because it did not object to the contract's fixed-price basis "before the contract was awarded." U.S. Br. at 11 (citing Pet. App. at 11a-14a). But there was *no way for AT&T to have known* that the Under Secretary of Defense for Acquisition had not made the "realistic pricing" and "equitable and sensible allocation of program risk" determination required by § 8118, a statute which the Government's brief emphasizes was enacted "just nine days" before the contract was awarded on New Year's Eve, 1987. *Id.* at 2. Because AT&T was not aware of DoD's violation of § 8118 when the contract was awarded, it had no basis for objecting. (AT&T did object after learning of the violation (*see* Pet. at 7-8).)

Nor would it have been rational for AT&T, which was *competing* for the RDA project, to "request a cost-reimbursement contract" (U.S. Br. at 11) in response to DoD's solicitation for "competitive bidding" on a "fixed price incentive fee contract." Pet. App. at 35a. Indeed, DoD's "solicitation specified that award would be made to the offeror deemed most advantageous to the government, technical risk, *price*, and other factors considered." *Gould, Inc. Ocean Sys. Div.*, B-229965, 88-1 CPD ¶ 457 at 2 (May 16, 1988) (emphasis added). As with virtually all competitively bid DoD contracts, there was simply no room for negotiation regarding the type of contract to be awarded. *See* Pet. at 4.

The Government's brief (U.S. Br. at 11-12) also relies upon what Judge Newman's dissenting opinion

accurately describes as the majority's "strange" and "speculative theories" (*none* of which, she emphasized, are based on "evidence or findings" in the record) as to why AT&T somehow has waived the right to claim additional compensation simply because it was the low bidder on the contract. Pet. App. at 17a. To support these theories, the Government asserts that "[a]lthough the Navy determined AT&T's proposal to be *technically inferior* to that of a competitor [Gould], the Navy awarded the contract to AT&T based upon the significantly reduced price offered by AT&T." U.S. Br. at 2 (emphasis added). In denying Gould's protest against the award to AT&T, however, the Comptroller General's decision explains that "the contracting officer properly looked *behind* the technical scores of Gould and AT&T and found that the 4-point advantage enjoyed by Gould . . . *did not reflect technical superiority*." *Gould, Inc. Ocean Sys. Div.*, *supra* at 5 (emphasis added). Thus, the Government's (and lower court's) premise that AT&T underbid "technically superior competitors" (U.S. Br. at 11) is outrageously incorrect.

Moreover, it was well settled until *AT&T V* that the Government may not benefit by violating a procurement statute. "The contractor cannot, by waiver, permit the Government to enter an illegal contract . . . When a contract clause drafted by the Government is inconsistent with law, whether the [contractor] inquired, protested, accepted or otherwise assumed any risks regarding the same is not controlling; the impropriety will not be allowed to stand." *Mapco Alaska Petroleum, Inc. v. United States*, 27 Fed. Cl. 405, 416 (Ct. Cl. 1992) (citation omitted); *see also Beta Sys., Inc. v. United States*, 838 F.2d 1179, 1186 (Fed. Cir. 1988) (Government cannot benefit even if contractor knowingly agreed to an illegal contract term); Pet. at 26; Br. for *Amici Curiae* at 18-20. Having vastly profited from its brazen disregard of § 8118 to the great financial detriment of a defense contractor whose interests that statute was supposed to protect, the Government cannot now shroud its unclean hands with a flimsy assertion of waiver.

Respectfully submitted,

Of Counsel

STEPHEN R. ROSEN
LUCENT TECHNOLOGIES INC.
Murray Hill, NJ

THOMAS R. SUHER
GORDON LAW OFFICES
Greensboro, NC

C. STANLEY DEES
Counsel of Record
LAWRENCE S. EBNER
MICHAEL A. HOPKINS

McKENNA LONG &
ALDRIDGE LLP
1900 K Street, N.W.
Washington, D.C. 20006
(202) 496-7500

Attorneys for Petitioners

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